THE CITY OF SAN DIEGO

Redevelopment Agency's Report

DATE ISSUED: December 2, 2005 REPORT NO. RA-05-37

ATTENTION: Honorable Chair and Members of the Redevelopment Agency
Docket of December 6, 2005

SUBJECT: Interim Financing for Affordable Housing Collaborative Program and Other Priority Redevelopment Projects

SUMMARY

Issue - Should the Redevelopment Agency:

1) Authorize the issuance of a Request for Proposals to secure a bank line of credit to provide funding for the Affordable Housing Collaborative Program, and other priority projects for the City Redevelopment project areas?

2) Conceptually approve the treatment of leveraged Low- and Moderate-Income Housing set-aside funds as a funding pool to provide funding for Affordable Housing Collaborative Program projects without regard to the origin of the set-aside funds?

3) Direct the Redevelopment Agency to determine its ability to commit additional resources to the Affordable Housing Collaborative Program to continue funding affordable housing projects beyond the initial $55 million allocation?

Executive Director's Recommendation – That the Redevelopment Agency should:

1) Authorize the issuance of a Request for Proposals to secure a bank line of credit to provide funding for the Affordable Housing Collaborative Program, and other priority projects for the City Redevelopment project areas.

2) Conceptually approve the treatment of leveraged Low- and Moderate-Income Housing set-aside funds as a funding pool to provide funding for Affordable Housing Collaborative Program projects without regard to the origin of the set-aside funds.

3) Direct the Redevelopment Agency to determine its ability to commit additional resources to the Affordable Housing Collaborative Program to continue funding affordable housing projects beyond the initial $55 million allocation.

Other Recommendations – On February 2, 2005, representatives from the San Diego Regional Chamber of Commerce presented to the Land Use and Housing Committee a list of 14 separate housing policy recommendations intended to address the on-going affordable housing crisis in San Diego. The first housing policy recommendation was to "Extend the Notice of Funding Availability (NOFA) process and expedite the approval process of such funding. City of San Diego should raise additional money and increase the amount for affordable housing projects."

Fiscal Impact – A line of credit may require an origination fee, in addition to annual interest payments, expected to range from 5.00% to 6.50% depending on the amount of the line of credit, and the term. Assuming a maximum line of credit totaling $78 million, with a 6.00% annual interest rate and a three-year term, annual payments are estimated to be approximately $4.68 million. Payments required each fiscal year would depend on the timing and amount of funds actually drawn down. Initial costs for a line of credit of this magnitude are estimated at approximately $50,000. Funding for initial costs and annual payments would come from tax increment and low-and moderate-income housing funds from each of the respective redevelopment project areas. It is proposed that the line of credit would ultimately be paid off with a permanent long-term bond issuance. An independent fiscal consultant report is currently being prepared for each project area and will show that sufficient tax increment revenue is currently available and will continue to be generated on an annual basis to support the annual payments on the line of credit, other current bond and developer obligations, and could support future bond issuances to ultimately pay off the line of credit. Final sizing of the line of credit will depend on the proposals received and the actual need for funds in each project area.

BACKGROUND

In August 2002, the City Council approved the concept of leveraging the Redevelopment Agency's Low- and Moderate-Income Housing set-aside funds to create up to $55 million in affordable housing financing to fund the Affordable Housing Collaborative Program through a Notice of Funding Availability (NOFA). In January 2003, the Agency issued the NOFA to seek proposals to develop new affordable housing units within the City of San Diego. The City's Redevelopment Division, the Centre City Development Corporation (CCDC), the Southeastern Economic Development Corporation (SEDC) and the Housing Commission have been working together as the Affordable Housing Collaborative to implement projects submitted in response to the NOFA.

Together, the Affordable Housing Collaborative has developed common goals, priorities and criteria for the review and approval of proposed affordable housing projects. Projects are reviewed by the Collaborative Review Team and the Executive Loan Committee, which include staff and appointed representatives of the agencies that comprise the Affordable Housing Collaborative. The process has resulted in consistency during negotiations, a standardization of terms and conditions related to the subsidies provided by the Redevelopment Agency for all of its affordable housing projects, a sharing of consultants and an institutional structure by which the representative agencies can work collectively on affordable housing issues on a regular basis.

The Agency issued housing bonds for the Horton Plaza and Centre City project areas to provide the $40 million contribution from the CCDC-administered project areas. It was planned that the redevelopment project areas administered by the City Redevelopment Division would provide the remaining $15 million. In 2003, housing bonds were also issued for the City Heights project area and provided $2.0 million towards this amount.

Since the last Agency bond issuances, Standard & Poor's suspended the City's and the Redevelopment Agency's ratings. While the Redevelopment Agency is an entity which is legally separate from the City, the Redevelopment Agency's financial statements are contained in the City's Comprehensive Annual Financial Report (CAFR), which has not been made available to the public since Fiscal Year 2002. Because audited financial information is not yet available, it has become apparent that the Redevelopment Agency cannot have access to funding through a public offering at this time, which is the traditional borrowing instrument during normal times. However, tax increment revenues continue to grow within the Agency's redevelopment project areas, and demand for affordable housing units continues to increase.

DISCUSSION

In total, almost $43 million has been committed to Affordable Housing Collaborative Program projects, creating 673 affordable housing units, with eight approved housing projects. From the initial commitment of $55 million in Agency funds, only $12 million remains. This remaining amount is currently unfunded, but the proposed line of credit is designed to provide at least that much funding and potentially more. Eleven projects totaling $60.7 million in requested subsidy are currently in review and exceed the balance of funds by $48.7 million. Some of these projects have funding which has been tentatively identified, if the projects are recommended to move forward for Agency approval. However, the majority of funding for the balance of the Affordable Housing Collaborative Program is currently unidentified, as shown in the table.

AFFORDABLE HOUSING COLLABORATIVE PROJECTS UNDER REVIEW				
Balance of Funding		**$12,000,000**		
NOFA Project	**Area**	**Identified Amount**	**Unidentified Amount**	**Possible source, if identified:**
La Entrada	Barrio Logan		$ 8,000,000	
Boulevard at North Park	North Park	3,860,000		Future project specific TI
Boulevard Apartments	North Park		2,400,000	
Centrepoint	Crossroads	7,200,000		Future project specific TI
Lafayette Hotel	North Park		4,000,000	
Aztec Inn	Crossroads		1,440,000	
Los Vientos	Barrio Logan		7,820,000	
The Paseo	College Comm	10,500,000		Future project specific TI
Veterans Village Phase III	North Bay	4,000,000		North Bay bonds, and low/mod TI
2525 Second Avenue	Uptown		7,500,000	
Logan Ave Demonstration	Barrio Logan		4,000,000	
TOTAL SUBSIDY		**$25,560,000**	**$35,160,000**	**$ 60,720,000**
Amount in excess of $55 million:				**$ 48,720,000**

The Affordable Housing Collaborative Program emphasizes the leveraging of funds from other funding sources. Because of this, most projects apply for tax credits or other programs which require funds from the Agency to be committed in advance of the application period. Also, in some instances, Agency funds are used to purchase property, allowing a developer to have site control in order to secure tax credit funding. Without the continued commitment of Agency funds, projects may be prevented from applying for tax credits, and could result in project delays or the inability for some projects to move forward.

As shown in the table, many projects under review are located in project areas that currently generate minimal tax increment. Specifically, three projects totaling $19.8 million in requested subsidies are located in the Barrio Logan project area. It is infeasible for the Barrio Logan project area to provide funding in this amount from its own tax increment revenues. However, it is possible for Low- and Moderate- Income Housing funds from other redevelopment project areas to be authorized for allocation for appropriate housing projects within another project area. It is requested that conceptual approval be given to treat the leveraged housing funds as a funding pool in order to allow housing projects throughout the City to be funded regardless of the origin of the tax increment funding. As an example, housing funds are likely to be available in the Naval Training Center and North Bay project areas, while housing project needs exist within the Barrio Logan project area. Provided certain requirements are met, and findings of benefit can be made, it may be proposed that the Naval Training Center and North Bay housing funds be allocated to fund project costs within the Barrio Logan or other project areas.

This concept of a funding pool is consistent with the initial design of the Affordable Housing Collaborative Program. However, projects thus far have primarily been located outside of the City's downtown and have been funded from housing funds from the CCDC-administered project areas in the downtown area. Since the remaining funds are to come from the City's Redevelopment project areas, and it is expected that many projects may be located within the Barrio Logan project area, it is important to know if the funding pool concept is acceptable and can be assumed for purposes of borrowing housing funds to continue the Affordable Housing Collaborative Program.

OTHER PRIORITY REDEVELOPMENT FUNDING NEEDS

Naval Training Center

In July 2003, the Agency entered into the Third Implementation Agreement to the DDA with McMillin-NTC, LLC which requires Agency reimbursement of additional City-imposed requirements for water, storm drain, and streetlight improvements, up to $8.5 million, plus interest. Repayment of these costs is to come from available tax increment from the Naval Training Center project area, less amounts required to be set-aside for housing and tax-sharing purposes. To fund this agreement, the Agency agreed to make good faith efforts to issue bonds by December 2005 with provisions for an extension to December 2006. Interest is calculated from the time the developer provides payments to its contractor at prime rate plus 0.50%, with immediate adjustments when the prime rate changes. The prime rate is currently 7.0%. To date, the Agency has reimbursed McMillin-NTC for over $1.2 million for all requests made from funds on hand. Estimates provided by McMillin-NTC indicate that the amount of the reimbursement requests will escalate with all remaining funds to be requested in February ($2.8 million) and June 2006 ($4.6 million), which will exceed the tax increment funds to be generated by the project area this year. Leveraging the annual NTC tax increment revenue stream by utilizing the proposed line of credit will allow the Agency to provide funds as they are needed by McMillin-NTC, and will minimize the Agency's borrowing costs compared to the existing arrangement with McMillin-NTC.

The Naval Training Center Reuse Committee established a Homeless Subcommittee to support a financing and implementation plan for an off-site Homeless Assistance Element for the NTC Reuse Plan to provide 150 off-site transitional housing units. A portion of the $7.5 million committed to this plan was authorized from funding to be generated by the Naval Training Center's Low- and Moderate-Income Housing funds. The participants under the Homeless Assistance Agreement are formulating their respective project plans and funding under the agreement is required to implement the projects. With the annual receipt of significant tax increment funding, the Agency is now able to leverage funds from its annual tax increment stream to fulfill the obligation under the Homeless Assistance Agreement, and excess housing funds raised with the line of credit could be made available to the Affordable Housing Collaborative Program for unfunded projects in other project areas.

North Park Theatre and Related Projects

Since April 2002, the Agency has entered into various agreements related to the North Park Theatre, and the North Park Public Parking Facility. In October 2004, the Third Implementation Agreement for the North Park Theatre was approved and resulted in a developer loan totaling $3,335,000, and initiated quarterly interest-only payments on the outstanding balance. The agreement also allowed for an escalating interest rate on the outstanding balance after project completion. Interest on the outstanding balance of the loan is calculated at prime plus 2% for the first two years following project completion, and increasing by one-half percentage point each year thereafter, not to exceed prime plus 4% or the maximum permitted by law. The prime rate is currently 7%. Construction of the parking facility near the Theatre will be completed in January 2006. Development cost overruns, including increased land acquisition costs, on the parking facility are to be financed by the developer at a rate calculated as prime plus two percent (2%), not to exceed twelve percent (12%) per year, and the Agency is obligated to repay the developer's loan to the Agency within twelve months of completion of construction. These costs are currently estimated at $4.3 million. The original repayment plan contemplated the sale of Agency-owned property located behind the Theatre, with the sale proceeds to be dedicated to the Theatre loan repayment. However, the disposition of this property is now being reconsidered, and may be unavailable for this use. The costs overruns related to the parking facility were planned to be repaid using available tax increment in the project area, with the expectation that a long-term bond issuance could be completed in the near future to repay any remaining balance. Utilizing a line of credit will allow the Agency to complete the repayment plans as required by the various agreements at a financing rate considerably lower than developer financing.

City Heights Projects

Opportunity sites for proposed mixed-use developments, which may include affordable housing, have been identified within the City Heights project area. As land costs most likely will increase over time, securing funds now to allow for the purchase of land would benefit the Redevelopment Agency by reducing project costs and possible future subsidies. If available sites are acquired by others, opportunities for key redevelopment projects may be lost, or could result in increased project costs for the relocation of businesses that may choose to locate there in the interim.

Several other projects are currently in development or negotiation where Redevelopment Agency funding will be necessary in the months ahead. Increased construction costs related to the City Heights Square and Auburn Park projects may result in an additional need for increased subsidies. In addition, the popular Home in the Heights First Time Homebuyer Assistance and the City Heights Rehabilitation Loan Programs are currently oversubscribed and will be seeking additional funding as it becomes available.

PLAN OF FINANCE

Under normal circumstances, the plan of finance would include securing underlying ratings, seeking bond insurance, and structuring a competitive sale of long-term fixed-rate tax allocation bonds. However, the rating suspension in September 2004 by Standard and Poor's affected the Redevelopment Agency's outstanding debt, along with the City's General Fund debt. This suspension significantly impacts the Agency's ability to obtain ratings on future issuances and to secure bond insurance until the audited financial statements are released. Discussions with each of the rating agencies and bond insurers indicate that the City's current financial situation impacts the Redevelopment Agency, and clearly a relationship exists between the two entities that cannot be terminated. Because of this, a request for ratings and for bond insurance for a Redevelopment Agency bond issuance would also require a thorough review of the City's finances. Given this environment and the impact this may have on the disclosure process and pricing for long-term debt, it is recommended to instead structure an interim financing that would be taken out within the next three to five year period by a long-term fixed rate issuance of tax allocation bonds. The interim financing plan would allow projects currently in development or construction to continue without delay, and would permit the Agency to achieve savings over developer borrowing arrangements currently in place.

It is proposed that a line of credit be established for the City Redevelopment project areas. Security for the line would be either a subordinate or parity pledge of housing set-aside tax increment from the City Heights, North Bay, North Park and NTC project areas, and general tax increment funds from the City Heights, North Park and Naval Training Center project areas. The line of credit could be structured to allow for both taxable and tax-exempt purposes, depending on the uses of funds. The housing projects would primarily require taxable funds, since the Affordable Housing Collaborative Program typically structures its subsidies as residual receipts loans. Once the projects are funded there may be a possibility of structuring the long-term takeout as tax-exempt if the housing subsidy is instead structured as a grant and not a loan.

Informal queries have been made by the Agency's financial advisor to determine the initial feasibility of a line of credit for these purposes. All institutions contacted indicated an interest in providing a line of credit to the Redevelopment Agency. Because of this, it is recommended that a Request for Proposals be issued to initiate a process to solicit complete terms and conditions, and to secure the most competitive pricing for a bank line of credit.

LINE OF CREDIT TIMELINE

Provided that approval to issue the Request for Proposals is received, it is anticipated that the RFP could be issued within a few days. As the holiday period is approaching, the response period will be extended to allow for complete responses from as many institutions as possible, with a submission date during the first week of January 2006. Review of the proposals could be accomplished the following week, and a recommendation for a specific line of credit provider, along with detailed information about amounts to be borrowed, the timing, and related costs could be brought forward to the Redevelopment Agency at the first meeting in February 2006. Based on this timeline, it is expected that funds could be received by the Redevelopment Agency at the end of February or the beginning of March 2006.

THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

The Redevelopment Agency's financial advisor, Kitahata & Company, has also served as the financial advisor for the Redevelopment Agency of the City of San Jose. The City of San Jose's Housing Department, which administers their Redevelopment Agency's Low- and Moderate-Income Housing Set-Aside Funds, established a $30 million line of credit from First Union Bank, in March 1999. The line of credit is secured by a subordinate pledge of the Agency's housing set-aside funds. The line has been increased to $50 million, is now from the Bank of New York, and has been extended to April 2006. When the line gets close to its limit, the Agency issues long-term housing set-aside bonds to pay off the line of credit, and then keeps it open to fund new projects. The line of credit allows for bonds to be issued only when necessary, once project commitments are finalized and funded from all sources. It also allows for the maximum amount of long-term tax-exempt debt to be issued, instead of initially issuing all taxable debt, once the subsidies to the various projects have been structured, minimizing borrowing costs. The line of credit was implemented by San Jose as a prudent fiscal management tool.

CONCLUSION

Given the current situation facing the City, the lack of audited financials and the suspension of the City's and the Redevelopment Agency's ratings by Standard and Poor's, it is recommended that the Redevelopment Agency authorize the issuance of a Request for Proposals for a bank line of credit to provide funding for the Affordable Housing Collaborative Program, and other priority project needs for the City Redevelopment project areas.

In addition, in order to continue to fund projects submitted under the Affordable Housing Collaborative Program, it requested that conceptual approval be given for the treatment of leveraged Low- and Moderate-Income Housing set-aside funds as a funding pool to fund Affordable Housing Collaborative Program projects without regard to the origin of the set-aside funds.

As project submissions under the Affordable Housing Collaborative Program exceed the initial $55 million commitment of funds, it is recommended that the Redevelopment Agency determine its ability to commit additional resources to continue funding affordable housing projects beyond the initial $55 million allocation. Because this process has resulted in consistency, standardization, and an institutional structure by which the representative agencies can work collectively on affordable housing issues on a regular basis, it is recommended that the Affordable Housing Collaborative Program be continued, and additional funding be identified and committed to this program.

Respectfully submitted,

Maureen Ostrye Deputy Executive Director	Approved: Debra Fischle-Faulk Assistant Executive Director